

1-1-1988

The Strange Case of Fraud on the Market: A Label in Search of a Theory

Barbara Black

Pace Law School

Follow this and additional works at: <http://digitalcommons.pace.edu/lawfaculty>

Recommended Citation

Black, Barbara, "The Strange Case of Fraud on the Market: A Label in Search of a Theory" (1988). *Pace Law Faculty Publications*. Paper 13.

<http://digitalcommons.pace.edu/lawfaculty/13>

This Article is brought to you for free and open access by the School of Law at DigitalCommons@Pace. It has been accepted for inclusion in Pace Law Faculty Publications by an authorized administrator of DigitalCommons@Pace. For more information, please contact cpittson@law.pace.edu.

THE STRANGE CASE OF FRAUD ON THE MARKET: A LABEL IN SEARCH OF A THEORY

Barbara Black*

INTRODUCTION

Reflecting its haphazard origins,¹ rule 10b-5 has developed a split personality. At its most elemental, it is simply the federal securities laws' equivalent of the common law tort of deceit.² But it has also become a complex, wide-ranging remedy, extending beyond common law, available to injured investors.³ Nowhere is the confusion sur-

* Professor of Law, Pace University School of Law. B.A., Barnard College; J.D., Columbia University School of Law. The author gratefully acknowledges the helpful comments of James J. Fishman and Margaret V. Sachs and the research assistance of David Varoli, Pace Law School Class of 1989.

¹ Rule 10b-5 was hastily adopted by the Securities and Exchange Commission in 1942, pursuant to its authority under section 10(b) of the Securities Exchange Act of 1934, to enable it to bring enforcement actions against corporate insiders who committed fraud in the purchase of securities. See 15 U.S.C. § 78j(b) (1982); 17 C.F.R. § 240.10b-5 (1988). The circumstances of its adoption are recounted in ABA Section of Corp., Banking and Bus. Law, *Conference on Codification of the Federal Securities Laws*, 22 BUS. LAW. 793, 921-23 (1967) (remarks of Milton Freeman) (recalling the now infamous statement of Commissioner Sumner Pike during the decision to adopt rule 10b-5: "Well," he said, "we are against fraud, aren't we?").

Federal courts consistently have implied a private cause of action under section 10(b) and rule 10b-5, beginning with *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 513-14 (E.D. Pa. 1946). The Supreme Court first recognized the existence of a private claim in a footnote in *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971), remarking that "[i]t is now established that a private right of action is implied under § 10(b)." See also *Basic Inc. v. Levinson*, 108 S. Ct. 978, 983 (1988) (noting that "[j]udicial interpretation and application, legislative acquiescence, and the passage of time have removed any doubt that a private cause of action exists for a violation of section 10(b) and Rule 10b-5, and constitutes an essential tool for the enforcement of the 1934 Act's requirements").

² See *United States v. Chiarella*, 445 U.S. 222, 235 (1980) (what rule 10b-5 catches must be common law fraud); *Peil v. Speiser*, 806 F.2d 1154, 1160 (3d Cir. 1986) ("Section 10 was built on, and retained, many of the characteristics of the common law tort action of deceit"); *Huddleston v. Herman & MacLean*, 640 F.2d 534, 547 n.21 (5th Cir. Unit A Mar. 1981) (noting that "[t]he implied cause of action under Rule 10b-5 'is essentially a tort claim,' derived from the common case action of deceit" (citation omitted)), *aff'd in part, rev'd in part*, 459 U.S. 375 (1983); *The Supreme Court, 1971 Term*, 86 HARV. L. REV. 1, 269-70 (1972) (claiming that the elements of common law fraud are often deemed necessary for liability under rule 10b-5). Note, *The Nature and Scope of the Reliance Requirement in Private Actions Under SEC Rule 10b-5*, 24 CASE W. RES. L. REV. 363, 366-69 (1973) (discussing the common law foundations of rule 10b-5); Note, *The Reliance Requirement in Private Actions Under SEC Rule 10b-5*, 88 HARV. L. REV. 584, 584-85 (1975) [hereinafter Note, *Reliance*] (noting that "it is not surprising that the common law tort of deceit has provided the foundation for developing the compensatory aspects of the right of action under the rule" (footnote omitted)). But see *id.* at 585 & n.7 (recognizing that courts have taken rule 10b-5 well beyond its common law birthplace).

³ *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983). In *Huddleston*, Justice Marshall, writing for the majority, noted that "a § 10(b) action can be brought by a purchaser or seller

rounding rule 10b-5 more evident than in the judicial treatment of the role of reliance.

To recover in fraud at common law, a plaintiff must establish both his reliance upon a misrepresentation⁴ and the loss caused by that reliance.⁵ The function of the reliance element is to establish causation in fact.⁶ Only if the misrepresentation induced the plaintiff to enter the transaction is there causation in fact. In addition, plaintiff must establish that the misrepresentation was a legal cause of his loss by establishing that the loss might reasonably be expected to result from the reliance.⁷ In other words, plaintiff must establish that the untruth was the proximate cause of his injury.

In open market securities transactions not involving direct communication between the maker of the misrepresentation and the investor, the common law's treatment of reliance as a *sine qua non* of recovery presents difficulties for plaintiffs. Purchasers, for example, who did not read a misrepresentation that inflated the value of the stock, and who did not even know about it, may be injured by the fraud if they bought the stock at the inflated price. Decision after decision recites the common law that reliance is a crucial element in every rule 10b-5 cause of action.⁸ Other cases inform us that the reliance requirement's only purpose is to establish causation,⁹ and

of 'any security' against 'any person' who has used 'any manipulative or deceptive device or contrivance' in connection with the purchase or sale of a security." *Id.* (quoting 15 U.S.C. § 78j (emphasis added by the Court)); see also *id.* at 388-89 ("the antifraud provisions of the securities law are not co-extensive with common law doctrines of fraud").

⁴ *Basic Inc. v. Levinson*, 108 S. Ct. 978, 989 (1988); RESTATEMENT (SECOND) OF TORTS § 525 (1976); W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER & KEETON ON THE LAW OF TORTS § 108 (5th ed. 1984) [hereinafter PROSSER & KEETON]; *The Supreme Court, 1971 Term*, *supra* note 2, at 269.

⁵ RESTATEMENT (SECOND) OF TORTS § 537; PROSSER & KEETON, *supra* note 4, § 110, at 767; *The Supreme Court, 1971 Term*, *supra* note 2, at 270.

⁶ RESTATEMENT (SECOND) OF TORTS § 546; PROSSER & KEETON, *supra* note 4, § 110, at 767.

⁷ RESTATEMENT (SECOND) OF TORTS § 548A; PROSSER & KEETON, *supra* note 4, § 110, at 767; Note, *Torts: Deceit: Determination and Measurement of Damages*, 43 CALIF. L. REV. 356, 358 (1955).

⁸ See, e.g., *Smith v. Ayres*, 845 F.2d 1360, 1363 (5th Cir. 1988); *Harris v. Union Elec. Co.*, 787 F.2d 355, 362 (8th Cir.), *cert. denied*, 479 U.S. 823 (1986); *Lipton v. Documentation, Inc.*, 734 F.2d 740, 742 (11th Cir. 1984) (en banc), *cert. denied*, 469 U.S. 1132 (1985); *Huddleston v. Herman & MacLean*, 640 F.2d 534, 547-48 (5th Cir. Unit A Mar. 1981) (en banc) (noting that "reliance is an issue in all Rule 10b-5 cases" (emphasis in original)), *aff'd in part, rev'd in part*, 459 U.S. 375 (1983); *Dwoskin v. Rollins, Inc.*, 634 F.2d 285, 291 n.4 (5th Cir. Jan. 1981); *Holmes v. Bateson*, 583 F.2d 542, 551 (1st Cir. 1978).

⁹ See, e.g., *Ross v. Bank South, N.A.*, 837 F.2d 980, 992 (11th Cir.) ("reliance established 'but for' causation"), *vacated and reh'g granted*, 848 F.2d 1132 (11th Cir. 1988); *Flamm v. Eberstadt*, 814 F.2d 1169, 1173 (7th Cir.) ("reliance' means only materiality and causation in conjunction"); cf. *Lipton*, 734 F.2d at 742 (stating that to "[r]equir[e] the plaintiff to show that

that causation can be shown in other ways.

The hornbook rules on reliance in a rule 10b-5 action are so bizarre that one must suspend one's analytical processes to recite them. Generally, reliance is an element that a plaintiff must prove in establishing a right to recovery.¹⁰ If plaintiff's claim is based on a misrepresentation, the plaintiff usually must show reliance upon the misrepresentation.¹¹ But if plaintiff's claim is based on a failure to disclose, reliance is presumed, and the defendant must establish plaintiff's nonreliance in order to rebut the presumption.¹² Plaintiff need not establish reliance in this case because it is "too hard" to prove he relied on silence.¹³ Since a failure to tell the complete truth, the basis of most securities fraud cases, can be viewed either as a nondisclosure or as an affirmative untruth,¹⁴ considerable litigation has concerned the characterization of the misstatements. Courts generally treat these "mixed" cases as cases involving misrepresentations.¹⁵

Fraud on the market has been superimposed on these traditional rules of reliance. In certain circumstances plaintiff does not have to prove that he relied on the misstatements, no matter how they are characterized.¹⁶ He is instead benefitted by a presumption that he relied on the integrity of the market for the shares. Development of fraud on the market reflects the ambivalence toward the appropriate

he reasonably relied on the defendants' misrepresentations is a means of establishing the 'casual link between the misrepresentation or omission and the injuries suffered by the private plaintiff' " (quoting *Dupuy v. Dupuy*, 551 F.2d 1005, 1016 (5th Cir.), *cert. denied*, 434 U.S. 911 (1977)).

¹⁰ See *Ross*, 837 F.2d at 992; *Peil v. Speiser*, 806 F.2d 1154, 1160-61 (3d Cir. 1986); *Lipton*, 734 F.2d at 742; *Landy v. FDIC*, 486 F.2d 139, 170 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974); *Sheftelman v. Jones*, 667 F. Supp. 859, 866 (N.D. Ga. 1987).

¹¹ See *Harris*, 787 F.2d at 366; *Caravan Mobil Home Sales v. Lehman Bros. Kuhn Loeb, Inc.*, 769 F.2d 561, 564 (9th Cir. 1985); *Zorbrist v. Coal-X, Inc.*, 708 F.2d 1511, 1516 (10th Cir. 1983); *Huddleston*, 640 F.2d at 547; *Rifkin v. Crow*, 574 F.2d 256, 262 (5th Cir. 1978).

¹² See *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 152-54 (1972); *Ross*, 837 F.2d at 992. In some jurisdictions, this presumption of reliance is applicable only if defendant had a duty to disclose to plaintiff. See *Cavalier Carpets, Inc. v. Caylor*, 746 F.2d 749, 756 (11th Cir. 1984); *Rifkin*, 574 F.2d at 260-62 & n.1; *Arthur Young & Co. v. United States Dist. Ct.*, 549 F.2d 686, 695 (9th Cir.), *cert. denied*, 434 U.S. 829 (1977); *Mottoros v. Abrams*, 524 F. Supp. 254, 259 (N.D. Ill. 1981); *Sullivan v. Chase Inv. Serv., Inc.*, 79 F.R.D. 246, 262 (N.D. Cal. 1978).

¹³ *Ross*, 837 F.2d at 992 (noting that "[t]he presumption is employed because it is so difficult for a plaintiff to prove a negative"); *Blackie v. Barrack*, 524 F.2d 891, 908 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976); *Chris-Craft Indus. v. Piper Aircraft Corp.*, 480 F.2d 341, 373-74 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973).

¹⁴ See *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1119 (5th Cir. 1988), *petition for cert. filed*, 57 U.S.L.W. 3695 (U.S. Mar. 13, 1989) (No. 88-1506).

¹⁵ See, e.g., *id.* at 1119; *Huddleston*, 640 F.2d at 548.

¹⁶ See generally *Black, Fraud on the Market: A Criticism of Dispensing with Reliance Requirements in Certain Open Market Transactions*, 62 N.C.L. REV. 435 (1984).

role of reliance. Its meaning and the questions it raises about the role of reliance and causation in rule 10b-5 claims are major unresolved issues in rule 10b-5 jurisprudence.

Fraud on the market is frequently explained as conferring upon the plaintiff a rebuttable presumption of reliance¹⁷ without much analysis of how the presumption can be rebutted. This is the traditional tort law explanation, referred to in this Article as reliance-based fraud on the market, or as the reliance approach. An alternative explanation of fraud on the market is that it eliminates reliance as a required element and places the analytical emphasis where it belongs: on causation. This is causation-based fraud on the market, also referred to as the pure causation approach. Under this pure causation approach, plaintiffs who were injured by the fraud can recover, despite their lack of reliance. Although to date many courts have been unwilling to articulate such a significant departure from common law tort principles, all the leading fraud on the market cases, including the Supreme Court's opinion in *Basic Inc. v. Levinson*,¹⁸ can be interpreted as supporting this approach. In the pages that follow, it is suggested that fraud on the market is best conceptualized in terms of this pure causation approach instead of the more frequently used reliance approach.

Part I of this Article will briefly discuss fraud on the market as a label attached to different factual situations, analyzing *Blackie v. Barrack*¹⁹ and *Shores v. Sklar*²⁰ as two paradigms of the label's application. Part II will discuss the Supreme Court's recent decision in *Basic*. It concludes that the Court did not analyze definitively fraud on the market, thus leaving open the possibility that a pure causation approach is an appropriate explanation of fraud on the market. The treatment and application of fraud on the market in the lower courts is next analyzed in three groups: those applying *Blackie*, those applying *Shores*, and finally those involving a classic form of market manipulation. In each instance, the significance of a pure causation approach

¹⁷ See, e.g., *Basic Inc. v. Levinson*, 108 S. Ct. 978, 992 (1988); *Peil v. Speiser*, 806 F.2d 1154, 1161 (3d Cir. 1986); *Lipton v. Documentation, Inc.*, 734 F.2d 740, 742 (11th Cir. 1984) (en banc), cert. denied, 469 U.S. 1132 (1985); *Shores v. Sklar*, 647 F.2d 462, 468 (5th Cir. May 1981), cert. denied, 459 U.S. 1102 (1983); *Tolan v. Computervision Corp.*, 696 F. Supp. 771, 773 (D. Mass. 1988); *Anderson v. Bank of the South, N.A.*, 118 F.R.D. 136, 142 (M.D. Fla. 1987); *Klein v. A.G. Becker Paribas, Inc.*, 109 F.R.D. 646, 650 (S.D.N.Y. 1986); *Rosenberg v. Digilog, Inc.*, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,274 (E.D. Pa. July 31, 1985); *Greenwald v. Integrated Energy, Inc.*, 102 F.R.D. 65, 68 (S.D. Tex. 1984).

¹⁸ 108 S. Ct. 978 (1988).

¹⁹ 524 F.2d 891 (9th Cir. 1975), cert. denied, 429 U.S. 816 (1976).

²⁰ 647 F.2d 462 (5th Cir. May 1981) (en banc), cert. denied, 459 U.S. 1102 (1983).

is discussed. The Article will conclude that fraud on the market is best used as a means of focusing on causation, and in some situations, dispensing with the reliance requirement.

I. FRAUD ON THE MARKET: *Blackie v. Barrack* AND
Shores v. Sklar

Fraud on the market²¹ permits plaintiffs who concededly did not read the fraudulent misstatements to recover. While the origins of fraud on the market can be traced back at least to the enactment of section 11 of the Securities Act of 1933,²² its rapid acceptance in recent years is largely attributable to two significant influences on securities law: economic theory and class action procedure. The "efficient capital market hypothesis," or the efficient market thesis, states that in free and actively traded markets, stock prices reflect fully all available information about the value of a corporation.²³ The market "transmits information to the investor in the processed form of a market price . . . [and acts] as the unpaid agent of the investor, informing him that given all the information available to it, the value of the stock is worth the market price."²⁴ Fraud on the market also provides a means of eliminating individual issues of reliance which would make securities fraud class actions impracticable, since under Rule 23(b)(3) of the Federal Rules of Civil Procedure questions of law or fact common to all members of the class must predominate over questions affecting only individual members.²⁵ Courts most fre-

²¹ "Fraud on the Market," as an independent phrase, made its jurisprudential debut in *Herbst v. Able*, 47 F.R.D. 11, 16 (S.D.N.Y. 1969). The origins and background of fraud on the market are analyzed extensively in my earlier article, *Black*, *supra* note 16, at 435, and so will not be repeated here. The purpose of this article is to refine the analysis of my earlier article and to concentrate on developments after the date of that article.

²² 15 U.S.C. § 77k (1982). Section 11 permits purchasers of shares issued under a registration statement to recover for material misstatements in the registration statement, whether or not they read the misstatement. *Id.* For discussion of the legislative history of the express remedy provisions in both acts, see *Black*, *supra* note 16, at 462-65. See also *Berle*, *Liability for Stock Market Manipulation*, 31 COLUM. L. REV. 264, 269 & n.9 (1931) (asserting that any buyers relying on the state of the market should be able to recover for misstatements which cause the market to arrive at a false valuation for the stock).

²³ For a brief explanation of the efficient capital market hypothesis that is intelligible to laymen, see *Fama*, *Random Walks in Stock Market Prices*, FIN. ANALYSIS J., Sept.-Oct. 1965, at 55 (excerpted in R. POSNER & K. SCOTT, *ECONOMICS OF CORPORATION LAW AND SECURITIES REGULATION* 156 (1980)).

²⁴ *In re LTV Sec. Litig.*, 88 F.R.D. 134, 143 (N.D. Tex. 1980).

²⁵ FED. R. CIV. P. 23. The rule states in part:

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder

quently refer to fraud on the market as establishing a rebuttable presumption of reliance. Examined in this light, the concept of fraud on the market does not eliminate the requirement of reliance; it just does not require plaintiff to talk about it.

Although the Supreme Court and virtually every circuit court has acknowledged the existence of a fraud on the market theory,²⁶ it is not a theory at all, but rather a label attached to some distinctly different factual situations. Its two most widely recognized forms are identified by the decisions which enunciated their version of fraud on the market: the Ninth Circuit's *Blackie v. Barrack*²⁷ and the Fifth Circuit's *Shores v. Sklar*.²⁸ In *Blackie*, plaintiffs had purchased shares of the corporation's stock in an actively traded secondary market.²⁹ They alleged that about forty-five documents released publicly by the corporation contained material misstatements that artificially inflated the price of the stock.³⁰ The Ninth Circuit held that in rule 10b-5 claims involving open market transactions individual members of the class did not have to prove their own reliance on the misstatements.³¹ According to the court, material misstatements have an impact on the trading price of the stock.³² Therefore, every investor who relies on the market's ability to determine the value of the stock based on

of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

...
(3) the court finds that the question of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy.

²⁶ See *Basic Inc. v. Levinson*, 108 S. Ct. 978, 992 (1988); *Panzirer v. Wolf*, 663 F.2d 365, 367 (2d Cir. 1981), *cert. denied*, 458 U.S. 1107 (1982); *Flamm v. Eberstadt*, 814 F.2d 1169, 1179-80 (7th Cir.), *cert. denied*, 108 S. Ct. 157 (1987); *Peil v. Speiser*, 806 F.2d at 1160; *Levinson v. Basic Inc.*, 786 F.2d 741, 750 (6th Cir. 1986), *vacated*, 108 S. Ct. 978 (1988); *Harris v. Union Elec. Co.*, 787 F.2d 355 (8th Cir.), *cert. denied*, 479 U.S. 823 (1986); *Lipton v. Documation, Inc.*, 734 F.2d 740 (11th Cir. 1984), *cert. denied*, 469 U.S. 1132 (1985); *T.J. Raney & Sons v. Fort Cobb, Okla. Irrigation Fuel Auth.*, 717 F.2d 1330, 1332 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984); *Shores v. Sklar*, 647 F.2d 462, 471 (5th Cir. May 1981) (en banc), *cert. denied*, 459 U.S. 1102 (1983); *Wachovia Bank & Trust v. National Student Mktg. Corp.*, 650 F.2d 342, 358 (D.C. Cir. 1980), *cert. denied*, 452 U.S. 954 (1981); *Blackie v. Barrack*, 524 F.2d 891, 906 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976).

²⁷ 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976).

²⁸ 647 F.2d 462 (5th Cir. May 1981) (en banc), *cert. denied*, 459 U.S. 1102 (1983).

²⁹ 524 F.2d at 906.

³⁰ *Id.* at 902.

³¹ *Id.* at 906.

³² *Id.* at 905-06.

the publicly available information has relied on those misstatements, even though he may have no direct knowledge of them.³³

*Shores v. Sklar*³⁴ involved an initial offering of revenue bonds where there was no well-developed secondary market.³⁵ The bonds dropped drastically in value shortly after their sale because of the default by the lessee of the industrial business premises.³⁶ The purchaser, deceased by the time of the litigation, had not read the offering circular, but had apparently relied on his broker's recommendations in purchasing the bonds.³⁷ The Fifth Circuit held that although the purchaser's failure to read the offering circular barred his executor from asserting a claim based on alleged material misstatements in the offering circular, it did not prevent him from asserting a claim based on the fraud of bringing to market bonds which were unmarketable absent such fraud, so long as the purchaser had relied on "the integrity of the offerings of the securities market."³⁸

Before proceeding, one must pause to marvel at the malleability of any theory that can encompass two such disparate factual situations. Because the securities in *Blackie* were actively and widely traded, the court emphasized the efficient market thesis and its view that the market price is an indicator of value upon which most investors rely.³⁹ Thus, the Ninth Circuit did not need to eliminate the reliance requirement; rather, it took the approach that reliance could be indirect, and plaintiffs need not establish that they read the misstatements. Indirect actual reliance could be presumed, but the presumption was rebuttable. In contrast, the efficient market thesis has no bearing in *Shores*, and so the Fifth Circuit could not look to the price of the bonds as conveying a value upon which the investor relied. Although the court used the term reliance,⁴⁰ the focus was solely on causation; plaintiffs suffered injury caused by the defendants' fraud, i.e., the marketing of worthless bonds.⁴¹ In a *Shores* case, once plaintiffs

³³ *Id.* at 907.

³⁴ 647 F.2d 462 (5th Cir. May 1981) (en banc), cert. denied, 459 U.S. 1102 (1983).

³⁵ *Id.* at 467. The record was unclear whether the buyer bought directly from the bond issuer or from his broker. However, the district court found that, regardless of the means of the sale, the purchase was part of the primary offering. *Id.*

³⁶ *Id.* at 463-64.

³⁷ *Id.* at 467.

³⁸ *Id.* at 469.

³⁹ *Blackie*, 524 F.2d at 907. "A purchaser on the stock exchanges . . . relies generally on the supposition that the market price is validly set and that no unsuspected manipulation has artificially inflated the price, and thus indirectly on the truth of the representations underlying the stock price—whether he is aware of it or not, the price he pays reflects material misrepresentations." *Id.*

⁴⁰ *Shores*, 647 F.2d at 464.

⁴¹ *Id.* at 466.

establish that the defendants fraudulently offered unmarketable securities, it is not at all clear that the defendants can avoid liability. Bringing the worthless securities to market caused the purchasers' injury, and seldom will there be an intervening factor significant enough to break the chain of causation. Indeed, the only common thread running through *Blackie* and *Shores* is that they were both class action cases. Thus, the theory of fraud on the market, if there is one, may be simply an explanation to eliminate the necessity of dealing with reliance issues whenever there is a securities fraud class action.

Shores, however, has been frequently criticized both because it applied fraud on the market to an initial public offering where there was no well developed secondary market, and because it permitted recovery on a showing of causation only.⁴² As a result, its continued existence is in doubt.⁴³ If *Shores* is disregarded, then fraud on the market, following *Blackie*, might be described simply as an approach which establishes a rebuttable presumption of reliance.

Application of fraud on the market has not been limited, however, to class actions or situations explainable in terms of a rebuttable presumption of reliance. While *Blackie* can be interpreted simply as a case involving indirect actual reliance,⁴⁴ it can also be viewed as a pure causation case.⁴⁵ The *Blackie* court recognized that a misstatement made in a well-developed trading market will be picked up by traders following the stock and have an impact on the price of the stock,⁴⁶ thus causing all traders injury.⁴⁷ *Blackie* can also be explained

⁴² See, e.g., 4 A. BROMBERG & L. LOWENFELS, SECURITIES FRAUD & COMMODITIES FRAUD, § 8.6(642) (1988) (describing *Shores* as the "most controversial example" of the fraud on the market theory as applied to an undeveloped market).

⁴³ See *infra* notes 129-42 and accompanying text (discussing uncertain status of *Shores* in the Fifth and Eleventh Circuits).

⁴⁴ In open market transactions, the purchaser indirectly relies on the accuracy of public information about a corporation because he relies on the "supposition that the market price is validly set and that no unsuspected manipulation has artificially inflated the price." *Blackie*, 524 F.2d at 907.

⁴⁵ See, e.g., *Panzirer*, 663 F.2d at 368; *Black*, *supra* note 16, at 448; see also *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 381 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975) (in which the court focused on causation).

⁴⁶ *Blackie*, 524 F.2d at 907.

⁴⁷ Plaintiffs must demonstrate that they were injured by the artificial inflation of the value of the stock. See *Packer v. Yampol*, 630 F. Supp. 1237 (S.D.N.Y. 1986). In *Packer*, the court took the position that plaintiffs did not establish any injury resulting from the purchase at an allegedly inflated value, since they alleged an ongoing conspiracy to inflate the price. *Id.* at 1240. Moreover, plaintiffs sought injunctive relief, not damages, to cure the misstatements which the court observed would cause them injury. The court evidently viewed the complaint as founded on corporate mismanagement and therefore barred under *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977). See *Packer*, 630 F. Supp. at 1243.

as a case in which the fraud is viewed, not as misstatements, but as fraud on a larger scale, or market manipulation, where plaintiff need only prove that the actions caused him injury.⁴⁸ Furthermore, there are other decisions that can be explained only in terms of causation: a recognition that investors can be injured by a misstatement even though they did not rely on it. In *Panzirer v. Wolf*,⁴⁹ for example, the Second Circuit invoked fraud on the market to allow a claim by a purchaser who said she bought stock in a corporation after a Wall Street Journal article predicted favorable corporate developments, which, she argued, would not have been written if the adverse information had been disclosed.⁵⁰ Although the Supreme Court's recent opinion in *Basic Inc. v. Levinson*⁵¹ accepted the use of fraud on the market to give class members a rebuttable presumption of reliance, it gives us no guidance as to when, if ever, fraud on the market can be used to eliminate the requirement of reliance altogether.

II. THE *Basic* DECISION

Basic Inc. v. Levinson,⁵² like *Blackie v. Barrack*,⁵³ involved a class action, but its facts present the other side of the coin. The plaintiffs in *Basic*, former holders of shares traded on the New York Stock Exchange, alleged that the corporation issued materially misleading press releases about merger negotiations that depressed the price of the securities.⁵⁴ In cases like *Blackie*, in which plaintiff alleges an artificial inflation in the price of the stock, misstatements that are intentionally made to inflate the price by themselves establish market manipulation,⁵⁵ because corporate management has an obvious interest in keeping the price of the stock high. In contrast, when the misstatements depress the stock price, as in *Basic*, it is difficult, without additional evidence of market manipulation (such as insider trading), to believe that management intended to do this. Without proof of wrongful intent, actions in which the market price is depressed will fail by reason of plaintiff's inability to establish the requisite scienter.

⁴⁸ See, e.g., *Fausett v. American Resources Mgmt. Corp.*, 542 F. Supp. 1234, 1238-39 (D. Utah 1982).

⁴⁹ 663 F.2d 365 (2d Cir. 1981), *cert. denied*, 458 U.S. 1107 (1982).

⁵⁰ *Id.* at 367.

⁵¹ 108 S. Ct. 978 (1988).

⁵² *Id.*

⁵³ 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976).

⁵⁴ *Basic*, 108 S. Ct. at 981.

⁵⁵ *Blackie*, 524 F.2d at 907.

Thus, because stock price depression cases will largely turn on scienter and not reliance or causation, the more common *Blackie*-type case of artificial inflation of the market price would have allowed for a more meaningful examination of fraud on the market. *Basic* was therefore a poor choice of a case for the Supreme Court's review of these issues.

Nevertheless, the Court decided, by a 4-2 vote, that it was proper for the lower courts to apply a rebuttable presumption of reliance.⁵⁶ In fact, the Court decided little, because Justice Blackmun made it clear that he was not "assess[ing] the general validity of the [fraud on the market] theory."⁵⁷ Instead, he threw the development of the theory back to the lower courts so they could continue to struggle with it.⁵⁸

In finding the presumption of reliance proper, Justice Blackmun set forth six reasons commonly offered by the lower courts to support a presumption of reliance, and analyzed them in a cursory fashion. One was the "class action" explanation: requiring proof of individual reliance would prevent plaintiffs from proceeding with a class action, since individual issues would overwhelm the common ones.⁵⁹ Another reason was an expansion of the view in *Affiliated Ute Citizens v. United States*⁶⁰ that plaintiffs should have the benefit of a presumption because it is difficult for them to establish reliance on silence.⁶¹ Requiring a plaintiff who has traded on an impersonal market to show a speculative state of facts would place on him "an unnecessarily unrealistic evidentiary burden."⁶² Neither of these two explanations addressed the substantive elements of securities fraud claims.

Three of the reasons given by Justice Blackmun suggested that at most only lip service need be given to the reliance requirement. First, while reliance is an element in rule 10b-5 claims, there are other ways to establish the causal connection between defendant's misstatements and plaintiff's injury.⁶³ Second, transactions in the modern securities markets differ from the face-to-face transactions contemplated in the early fraud cases, and the reliance requirement should reflect these differences.⁶⁴ Third, the presumption of reliance is con-

⁵⁶ *Basic*, 108 S. Ct. at 993.

⁵⁷ *Id.* at 989.

⁵⁸ *But see* 4 A. BROMBERG & L. LOWENFELS, *supra* note 42, § 8.6(611) ("[t]he Supreme Court endorsed the fraud-on-the-market-theory 4-2 in *Basic*").

⁵⁹ *Basic*, 108 S. Ct. at 989.

⁶⁰ 406 U.S. 128 (1972).

⁶¹ *Basic*, 108 S. Ct. at 990.

⁶² *Id.*

⁶³ *Id.* at 989.

⁶⁴ *Id.* at 989-90.

sistent with and supports the congressional policy embodied in the Securities Exchange Act of 1934, in which Congress enacted legislation on the express premise that the securities markets are affected by information.⁶⁵ But for Justice Blackmun's acknowledgment that "reliance is an element of a Rule 10b-5 cause of action,"⁶⁶ these reasons might be interpreted to eliminate the reliance requirement altogether. Justice Blackmun's last reason is mere rhetoric: the presumption is supported by common sense and probability, because no one " 'would knowingly roll the dice in a crooked crap game.' " ⁶⁷

Justice Blackmun did little to dispel the essential confusion surrounding fraud on the market: what do courts mean by a "rebuttable presumption" of reliance? If reliance is an indispensable element in a rule 10b-5 action, why should courts presume its existence? There are two possible explanations. First, once the lie is out in the marketplace, an investor who does not read the lie in its original form may nevertheless be influenced by it. He may read a newspaper article which was affected by the lie, or he may speak to a broker or an acquaintance who read the lie or heard about it from someone else. This sort of indirect actual reliance is both common and appropriate, but difficult for the investor to establish with specificity. Although the investor could certainly testify to the best of his recollection on how the investment decision was made, it may be appropriate for the courts simply to dispense with this proof.

Second, once the lie is out in the marketplace, a trader who has not relied on it in any way is affected by it if other traders have taken the lie into account in making their trading decisions, since the price at which the nonrelying trader trades is arrived at through the trades of the relying traders. The price of the stock is determined by the totality of information in the marketplace, correct or incorrect, if that information has been picked up and relied upon by traders in the stock. The validity of that statement is generally attributed to the efficient market thesis.⁶⁸ The fact that trades affect stock prices, however, is unrelated to the efficient market thesis, as is the fact that traders act upon the available information. In fact, full acceptance of the efficient market thesis would lead to skepticism that false information could have any significant impact on stock prices, since

⁶⁵ *Id.* at 990-91.

⁶⁶ *Id.* at 989.

⁶⁷ *Id.* at 991 (quoting *Schlanger v. Four-Phase Sys.*, 555 F. Supp. 535, 538 (S.D.N.Y. 1982)).

⁶⁸ See *In re LTV Sec. Litig.*, 88 F.R.D. 134, 143-45 & n.4 (N.D. Tex. 1980).

traders should recognize its falsity and disregard it.⁶⁹ Traditionally, manipulation of stock prices has been a greater problem with less widely traded securities; where a stock has few market makers and few analysts following it, it is easier for a misstatement to have a dramatic impact on the stock price. It is thus appropriate for the courts to minimize the question of individual reliance, and focus on the question of whether the misstatement had an impact on stock prices, taking into account other information available in the marketplace. Thus, the focus should be on materiality and causation.

Under the second explanation, causation, not reliance, is the relevant inquiry. This view of fraud on the market as a pure causation theory recognizes that an investor's injury can be caused by a misstatement on which he did not rely, a view that common law tort law did not accept.⁷⁰

The key issue in determining the scope of fraud on the market is how to rebut the presumption of reliance.⁷¹ The more difficult it is for a defendant to rebut this presumption, the more closely fraud on the market resembles a pure causation approach than an indirect actual reliance approach. According to Justice Blackmun, "[a]ny showing that severs the link between the alleged misrepresentation and . . . [the investor's] decision to trade at a fair market price"⁷² would rebut the presumption. The Sixth Circuit in *Basic* said the defendant could rebut the presumption by showing that an individual plaintiff would have traded even if he knew the truth.⁷³ Justice Blackmun gave several situations in which the presumption could be rebutted,

⁶⁹ For criticism of the efficient capital markets hypothesis applied to law, see *Basic*, 108 S. Ct. at 994-96 (White, J., concurring in part, dissenting in part). The fact that every few years there are massive frauds uncovered, like the ones involving National Student Marketing and Equity Funding, leads to skepticism about the efficient capital market thesis. See *Wachovia Bank & Trust, Co., N.A. v. National Student Mktg. Corp.*, 650 F.2d 342 (D.C. Cir. 1980), *cert. denied*, 452 U.S. 954 (1981); *In re Equity Funding Corp. of Am.*, 396 F. Supp. 1266 (C.D. Cal. 1975).

⁷⁰ The common law requirement is well stated by the Restatement (Second) of Torts: "If the recipient [of a fraudulent misrepresentation] does not in fact rely on the misrepresentation, the fact that he takes some action that would be consistent with his reliance on it and as a result suffers pecuniary loss, does not impose any liability upon the maker." RESTATEMENT (SECOND) OF TORTS, § 537, comment a. Justice White, in his opinion in *Basic*, admonished the majority for turning its back on the common law precepts of fraud, stating that "the Court, I fear, embarks on a course that it does not genuinely understand, giving rise to consequences it cannot foresee." *Basic*, 108 S. Ct. at 995 (White, J., concurring in part, dissenting in part) (footnote omitted).

⁷¹ For a comprehensive discussion of how various courts have addressed the rebuttable presumption created by the fraud on the market hypothesis, see 4 A. BROMBERG & L. LOWENFELS, *supra* note 42, § 8.6(600-62).

⁷² *Basic*, 108 S. Ct. at 992.

⁷³ *Id.*

including situations in which sellers who believed that the price was artificially low but nonetheless were forced to sell, either because of a court order or political pressure to divest themselves of the stock.⁷⁴ But even under a pure causation approach, these sellers should not be able to recover because they did not rely on the integrity of the market, but rather consciously rejected the market price. On the other hand, a plaintiff who decides to sell because he needs money to send his child to college or to pay his taxes does not consciously reject the market price and therefore should be able to recover. Although, under Justice Blackmun's approach, the plaintiff in the latter situation would be benefited by a rebuttable presumption of reliance, his recovery is best explained under a pure causation approach. If the plaintiff sold because he needed money, it would be impossible to either prove or disprove reliance on the market price. Thus, putting the burden on the defendant to rebut the presumption of reliance makes it an irrebuttable presumption, and disposition of the matter becomes purely a question of causation.

The pure causation approach makes even more sense when the plaintiff is a purchaser because it is even more unlikely that a purchaser would consciously reject the market price. A plaintiff who knew that the stock price was artificially overvalued generally would not be compelled by other reasons to make the purchase. In unusual situations, a purchaser might be so taken with a stock that he must have it at any price, but it would be rare for a plaintiff to admit this and rarer still for a defendant to prove it. The short seller, on the other hand, is an example of the rare trader who consciously disregards the market price. If the trader sells short anticipating a price decline that does not occur because of misstatements that artificially overvalue the stock, he suffers an injury. He does not rely on the market price yet can show causation. In most other situations, a pure causation approach would lead to the same results as a reliance-based approach. Thus, using causation-based fraud on the market to dispense with the reliance requirement courts can ground their decisions upon a more appropriate test of liability.

Justice White, concurring and dissenting in *Basic*, asserted that Justice Blackmun's opinion made it clear that investors who make an investment decision without regard to the misrepresentation, but who assume that the market price is correct, cannot recover.⁷⁵ This is wishful thinking on Justice White's part; Justice Blackmun never

⁷⁴ *Id.*

⁷⁵ *Basic*, 108 S. Ct. at 995-96 (White, J., concurring in part, dissenting in part).

said that such investors cannot recover. But Justice White is correct in saying that in these instances there is no link, in terms of reliance, between the alleged misstatement and the decision to trade at a fair market price. The link is one of causation, and is broken only by defendant's showing that the trader consciously rejected the market price. This further suggests the validity of a pure causation approach.

The Supreme Court could have acknowledged that rule 10b-5 actions are basically common law tort claims, required plaintiffs to establish reliance, and killed federal securities class actions. This would be consistent with its analysis in *United States v. Chiarella*,⁷⁶ which held that the rule did not recognize any duty owed to the marketplace in general. The Court could have recognized that rule 10b-5 actions have moved far away from their common law origins and adopted a pure causation theory. This would be consistent with the Supreme Court's approach in *Herman & MacLean v. Huddleston*.⁷⁷ Instead, in line with the cause of action's muddled development, the Court took a wait-and-see approach: let the lower courts wrestle with it some more, and then we'll decide what to do.

III. LOWER COURT DECISIONS

A. Blackie's Progeny

Every Circuit that has considered the form of fraud on the market developed in *Blackie v. Barrack* has adopted it.⁷⁸ The lower courts generally view *Blackie* as a case involving indirect actual reliance.⁷⁹ Since most of the decisions involve class certifications, however, the courts need not make any final determination of the substantive law.⁸⁰

⁷⁶ 445 U.S. 222, 235 (1980).

⁷⁷ 459 U.S. 375, 387-90 (1983). In *Huddleston*, the court recognized that rule 10b-5 is a more expansive remedy than that afforded under common law.

⁷⁸ See, e.g., *Peil v. Speiser*, 806 F.2d 1154, 1161 (3d Cir. 1986); *Harris v. Union Elec. Co.*, 787 F.2d 355, 367 & n.9 (8th Cir.) (en banc), cert. denied, 479 U.S. 823 (1986); *Lipton v. Documentation, Inc.*, 734 F.2d 740 (11th Cir. 1984) (en banc), cert. denied, 469 U.S. 1132, (1985); *Ross v. A.H. Robins Co.*, 607 F.2d 545, 553 (2d Cir. 1979), cert. denied, 446 U.S. 946 (1980) (all cases cited in *Basic*, 108 S. Ct. at 991 n.25).

⁷⁹ See, e.g., *Lipton*, 734 F.2d at 743; *Bell v. Cameron Meadows Land Co.*, 669 F.2d 1278, 1283-84 (9th Cir. 1982); *Kirby v. Cullinet Software, Inc.*, 116 F.R.D. 303, 307-98 (D. Mass. 1987); *Grossman v. Waste Mgmt. Inc.*, 589 F. Supp. 395, 404-05 (N.D. Ill. 1984); *Fausett v. American Resources Mgmt. Corp.*, 542 F. Supp. 1234, 1238 (D. Utah 1982).

⁸⁰ Thus, the courts typically recite that any decision on the merits is inappropriate at the stage of class certification, and therefore they should not address questions of whether reliance must be shown and what that reliance must be. See *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177 (1974); *Kirkpatrick v. J.C. Bradford & Co.*, 827 F.2d 718, 722-23 (11th Cir. 1987), cert. denied, 108 S. Ct. 1221 (1988); *Guenther v. Pacific Telecom, Inc.*, 123 F.R.D. 333 (D. Or. 1988); *In re IGI Sec. Litig.*, 122 F.R.D. 451, 456 (D.N.J. 1988); *Gorsey v. I.M. Simon & Co.*, 121 F.R.D. 135, 138-39 (D. Mass. 1988); *Priest v. Zayre Corp.*, 118 F.R.D. 552 (D. Mass. 1988); *In re Data Access Sys. Sec. Litig.*, 103 F.R.D. 130, 135 (D.N.J. 1984).

1. Applying the Presumption

a. Well-Developed Markets

Although the courts recite that *Blackie*'s presumption is only available in well-developed, open, or efficient trading markets, very few of them have analyzed what this means.⁸¹ So long as the securities are publicly traded, most courts accept the plaintiff's assertion that the market is efficient.⁸² Since the question usually is raised on either a motion involving class certification or a motion to dismiss, the courts frequently state that determination of this issue is inappropriate at that stage of the proceeding.⁸³ Courts have questioned whether the following were appropriate situations for application of the presumption: the market for a stock which was "thin and potentially volatile";⁸⁴ the market for American Depositary Receipts (ADRs);⁸⁵ and the market for stock in which there was takeover activity.⁸⁶ In situations involving a corporation's initial public offering, the courts are split on whether *Blackie* is applicable.⁸⁷ Courts have held that *Blackie* is

⁸¹ See generally 4 A. BROMBERG & L. LOWENFELS, *supra* note 42, § 8.6(641) (discussing the multifarious guises of the efficient trading markets to which the courts have applied fraud on the market principles).

⁸² In *Harman v. Lyphomed, Inc.*, 122 F.R.D. 522, 525 & n.1 (N.D. Ill. 1988), the court found the *Blackie* theory applicable since the issuer was eligible to use Form S-3. In *Biben v. Card*, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,462 (W.D. Mo. Jan. 6, 1986), the court granted class certification, although it recognized defendants' argument that the market for the stock was not well developed. It noted that reliance on factors other than market integrity might itself be typical of the class, and, in any event, the class could always be decertified at a later stage.

⁸³ See, e.g., *Gruber v. Price Waterhouse*, 117 F.R.D. 75 (E.D. Pa. 1987); *A&J Deutscher Family Fund v. Bullard*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,938 (C.D. Cal. Sept. 22, 1986); *Biben*, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,462; *Abelson v. Strong*, 644 F. Supp. 524 (D. Mass. 1986); *Reingold v. Deloitte Haskins & Sells*, 599 F. Supp. 1241 (S.D.N.Y. 1984).

⁸⁴ *Abelson*, 644 F. Supp. at 529.

⁸⁵ *Reingold*, 599 F. Supp. at 1264.

⁸⁶ *Finkel v. O'Brien*, No. 85-2539, 1986 WL 15569 (D.N.J. May 22, 1986).

⁸⁷ In *Arthur Young & Co. v. United States Dist. Ct.*, 549 F.2d 686 (9th Cir.), *cert. denied*, 434 U.S. 829 (1977), the Ninth Circuit held that purchasers of securities issued under a registration statement could rely on the offering price because of their right to rely on the regulatory process to ensure the accuracy of the disclosure, *id.* at 695. The decision has been criticized as an unwarranted extension of *Blackie*. District courts in the Ninth Circuit continue to follow *Blackie*. See *In re Fortune Sys. Sec. Litig.*, 680 F. Supp. 1360 (N.D. Cal. 1987); *Fine v. Rubin*, 623 F. Supp. 171 (N.D. Cal. 1985). Other district courts have held that *Blackie* is not applicable to initial public offerings. See *Masri v. Wakefield*, 106 F.R.D. 322 (D. Colo. 1984); *Gibb v. Delta Drilling Co.*, 104 F.R.D. 59 (N.D. Tex. 1984). Courts have found the *Blackie* rationale applicable, however, if the corporation already has an existing market for its stock. See, e.g., *Klein v. A.G. Becker Paribas Inc.*, 109 F.R.D. 646 (S.D.N.Y. 1986). In *In re Union Carbide Corp. Consumer Prods. Business Sec. Litig.*, 676 F. Supp. 458 (S.D.N.Y. 1987), the court held it was reasonable

inapplicable in the marketing of oil and gas limited partnerships,⁸⁸ as well as in private placements.⁸⁹

Not surprisingly, it has become common for plaintiffs to plead *Blackie* and *Shores* in the alternative: either the market was well developed, or the securities were unmarketable. These efforts, however, have been unsuccessful.⁹⁰ The combination of approaches apparently convinces courts that the plaintiff is really complaining of misstatements that artificially inflated the value of the security traded in an undeveloped market, in which situation plaintiff must establish reliance. This reveals one of the anomalies of *Blackie's* presumption. Conventional wisdom holds that it is easier to manipulate the price of thinly-traded securities, since the lack of trading volume makes stratagems that artificially affect the price more effective. According to *Blackie*, however, if the stock is traded in a well-developed market it is appropriate to presume that misstatements will be picked up and acted upon by a significant number of traders.⁹¹ The enigma of *Blackie* is this: if the markets are so efficient, why would so many traders be so gullible?

Blackie's presumption can be rebutted by a showing that most traders were not deceived by the misinformation, because of its inconsistency with other publicly available information, and therefore the misinformation did not have an effect on the price.⁹² One court, however, found defendant's attempt to establish this rebuttal "incredible" because the court felt it put a burden on plaintiffs to seek out information other than that supplied by the corporation.⁹³

to use fraud on the market when dealing with a new issue of rights to purchase stock of a publicly-traded corporation, *id.* at 467-68; *see also* Gruber v. Price Waterhouse, 117 F.R.D. 75 (E.D. Pa. 1987) (raising but not deciding the issue).

For another case alleging reliance on the regulatory process in a different context, see *Mishkin v. Peat, Marwick, Mitchell & Co.*, 658 F. Supp. 271 (S.D.N.Y. 1987), in which the trustee for the liquidation of a broker-dealer firm charged that defendant accounting firm's reckless conduct aided and abetted the president's fraudulent transactions. The court held that the complaint was not deficient for failing to allege reliance on the broker-dealer's audited financial statements, because plaintiff asserted reliance on the regulatory process to assure that broker-dealers are solvent. *Id.* at 273-76.

⁸⁸ *See* *Platsis v. E.F. Hutton & Co.*, 642 F. Supp. 1277 (W.D. Mich. 1986), *aff'd*, 829 F.2d 13 (6th Cir. 1987), *cert. denied*, 108 S. Ct. 1227 (1988).

⁸⁹ *See* *Lubin v. Sybedon Corp.*, 688 F. Supp. 1425, 1445 (S.D. Cal. 1988).

⁹⁰ *See, e.g.,* *Lubin*, 688 F. Supp. 1425; *Masri v. Wakefield*, 106 F.R.D. 322 (D. Colo. 1984).

⁹¹ *Blackie*, 524 F.2d at 906.

⁹² *Id.* The court also noted that the presumption can be rebutted by proving that the plaintiff purchased despite knowledge of the misrepresentations, or that he would have purchased even if he had known of the misrepresentation. *Id.*

⁹³ *In re Western Union Sec. Litig.*, 120 F.R.D. 629, 637-38 (D.N.J. 1988).

b. Necessity of a Scheme

Some earlier cases held that in the *Blackie* situation plaintiff must allege more than misstatements actionable under paragraph (b) of rule 10b-5,⁹⁴ and must allege a scheme to defraud under paragraphs (a) and (c).⁹⁵ In most cases, however, the courts held that such a scheme was sufficiently alleged so long as plaintiff asserted that there were misstatements contained in a number of documents issued over some period of time, the situation in *Blackie* itself.⁹⁶ More recently, however, courts have simply dispensed with the distinction between a misrepresentation and a fraudulent scheme.⁹⁷ Hence, the courts interpret fraud on the market as a variation of the classic misrepresentation case, rather than as a market manipulation case, reinforcing the view of *Blackie* as a case involving indirect actual reliance.

2. Rebutting the Presumption

In *Blackie*, the Ninth Circuit said that the defendant could rebut the presumption by showing that the purchaser knew of the misstatement or would have made the purchase even if he knew of the misstatement.⁹⁸ According to *Peil v. Speiser*,⁹⁹ a Third Circuit opinion

⁹⁴ Rule 10b-5 provides as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1988).

⁹⁵ See *Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356 (5th Cir. 1987) (en banc), *cert. denied*, 108 S. Ct. 1220 (1988). *Finkel*, however, was overruled on this point in *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1119 (5th Cir. 1988), *petition for cert. filed*, 57 U.S.L.W. 3695 (U.S. Mar. 13, 1989) (No. 88-1506); see also *Lipton v. Documentation Inc.*, 734 F.2d 740 (11th Cir. 1984), *cert. denied*, 469 U.S. 1132 (1985); *In re Union Carbide Corp. Consumer Prods. Business Sec. Litig.*, 676 F. Supp. 458, 465 (S.D.N.Y. 1987); *In re Consumers Power Co. Sec. Litig.*, 105 F.R.D. 583, 610 (E.D. Mich. 1985) (noting that the fraud on the market "theory works [when] plaintiffs have alleged a conspiracy to inflate stock values that runs throughout the class period").

⁹⁶ See, e.g., *Consumers Power*, 105 F.R.D. 583.

⁹⁷ See *Abell*, 858 F.2d 1104; *Peil v. Speiser*, 806 F.2d 1154, 1162 (3d Cir. 1986).

⁹⁸ *Blackie*, 524 F.2d at 906; cf. *Peil*, 806 F.2d at 1161, 1163 (rebuttal established if shown that "plaintiff would have purchased the stock even at the price it would have been at but for the misrepresentations").

⁹⁹ 806 F.2d 1154.

quoted by Justice Blackmun in *Basic*,¹⁰⁰ such a showing defeats the presumption that the misrepresentations caused an increase in the stock's value that induced the plaintiff to make his purchase.¹⁰¹ There is a distinct difference in tone between *Blackie* and *Peil*. In *Blackie*, the emphasis was on causation and injury: misstatements cause injury because they result in the purchaser's paying too much for the stock. The fraud results in injury to all investors in the stock. In *Peil*, on the other hand, the emphasis was on reliance: the misstatements caused the price of the stock to rise, and this increase induced the plaintiffs to purchase. The courts frequently express this as protecting the investor's reliance on the stock price as an accurate indication of the stock's value.¹⁰² The focus is thus on indirect actual reliance.

The difference between *Blackie* and *Peil* is exemplified in a subsequent Third Circuit opinion, *Zlotnick v. TIE Communications*,¹⁰³ in which the court stated that a purchaser who buys at a fraudulently inflated price but actually relies solely upon accurate information in purchasing cannot recover, because his bad valuation of the stock is independent of any alleged fraud.¹⁰⁴ The Third Circuit is apparently saying that this investor made his purchase based on factors unrelated to price and therefore did not rely on the price. Yet *Zlotnick's* interpretation of "reliance on the price" is not mandated by *Blackie* or even by *Peil*: a showing that the purchaser did not rely on the price is not the same as showing that he would have made the purchase if he had known of the misstatement. Therefore, the presumption should be rebutted only by a showing that the truth would not have made any difference to the particular investor.¹⁰⁵

a. Class Certifications

Typically, defendants in a securities fraud class action seek to block certification of the class on the grounds that individual issues of reliance make maintenance of a class action impracticable or that the named plaintiffs, because of questions about their own reliance, or lack of it, are atypical of the class. The courts generally resist attempts by defendants to individualize questions of reliance and hold

¹⁰⁰ *Basic Inc. v. Levinson*, 108 S. Ct. 978, 988-89 (1988) (citing *Peil*, 806 F.2d at 1160-61).

¹⁰¹ *Peil*, 806 F.2d at 1161.

¹⁰² See, e.g., *In re LTV Sec. Litig.*, 88 F.R.D. 134, 142-43 (N.D. Tex. 1980).

¹⁰³ 836 F.2d 818 (3d Cir. 1988).

¹⁰⁴ *Id.* at 824.

¹⁰⁵ See *Grossman v. Waste Mgmt., Inc.*, 589 F. Supp. 395, 405-06 (N.D. Ill. 1984).

that differences in reliance do not defeat typicality,¹⁰⁶ at least for purposes of class certification.¹⁰⁷ Nevertheless, if plaintiff's decision was based on "factors wholly extraneous to the market,"¹⁰⁸ he will be barred from representing the class. Reliance on a source of information that was based on the misstatement (actual indirect reliance) is appropriate conduct for investors, including reliance on a broker's recommendation¹⁰⁹ or on a financial publication.¹¹⁰ An investor who makes his decisions wholly apart from market considerations, however, would have his claim barred.¹¹¹ Similarly, although ordinarily

¹⁰⁶ See, e.g., *In re Western Union Sec. Litig.*, 120 F.R.D. 629, 638-39 (D.N.J. 1988); *Priest v. Zayre Corp.*, 118 F.R.D. 552, 554-55 (D. Mass. 1988); *Snider v. Upjohn Co.*, 115 F.R.D. 536, 555 (E.D. Pa. 1987); *In re Control Data Corp. Sec. Litig.*, 116 F.R.D. 216, 222 (D. Minn. 1986).

For examples of specific plaintiffs whom the court refused to find class action plaintiff ineligible to represent the class, see *In re Western Union Sec. Litig.*, 120 F.R.D. at 633 (plaintiff was a more sophisticated investor than other members of the class and purchased some of the stock after reading annual report which disclosed substantial losses); *Priest*, 118 F.R.D. at 554 (plaintiff relied on financial publication and computer program, as well as subjective preferences); see also *In re Electro-Catheter Sec. Litig.*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,643 (D.N.J. Dec. 3, 1987) (plaintiff bought shares without concern for corporation's financial well-being); *Gavron v. Blinder Robinson & Co.*, 115 F.R.D. 318 (E.D. Pa. 1987) (plaintiff also claimed direct reliance on broker's oral misrepresentation); *A&J Deutscher Family Fund v. Bullard*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,938 (C.D. Cal. Sept. 22, 1986) (plaintiff was sophisticated and made sell decisions on the basis of tax considerations); *Shamberg v. Ahlstrom*, 111 F.R.D. 689 (D.N.J. 1986) (plaintiff represented estate of deceased purchaser, and purchaser's reasons for purchasing unknown); *Finkel v. O'Brien*, No. 85-2539, 1986 WL 15569 (D.N.J. May 22, 1986) (plaintiff relied on broker); *Biben v. Card*, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,462 (W.D. Mo. Jan. 6, 1986) (plaintiff's sophistication and contacts with insiders).

On the other hand, in an individual action with facts strikingly similar to *Panzirer v. Wolf*, 663 F.2d 365 (2d Cir. 1981), *cert. denied*, 458 U.S. 1107 (1982) (discussed *supra* note 49 and accompanying text), the district court dismissed a complaint alleging that plaintiff purchased the stock because her broker told her a takeover was in the air, because she did not even know about the misrepresentations, which would have depressed the price of the stock and thus have benefitted her. *Augenstein v. McCormick & Co.*, 581 F. Supp. 452 (D. Md. 1984).

¹⁰⁷ See, e.g., *Priest*, 118 F.R.D. 552; *Gavron v. Blinder Robinson & Co.*, 115 F.R.D. 318 (E.D. Pa. 1987).

¹⁰⁸ The phrase is used in a number of opinions, including *Kirby v. Cullinet Software, Inc.*, 116 F.R.D. 303, 307 (D. Mass. 1987), and *Grossman v. Waste Mgmt., Inc.*, 100 F.R.D. 781, 788 (1984).

¹⁰⁹ See, e.g., *Ockerman v. King & Spalding*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,707 (N.D. Ga. Mar. 31, 1988); *Klein v. A.G. Becker Paribas Inc.*, 109 F.R.D. 646, 650 (S.D.N.Y. 1986); *Finkel v. O'Brien*, No. 85-2539, 1986 WL 15569 (D.N.J. May 22, 1986).

¹¹⁰ See, e.g., *Katz v. Comdisco, Inc.*, 117 F.R.D. 403 (N.D. Ill. 1987).

¹¹¹ Reported examples of this situation are very sparse. An investor who admitted to making his decisions based on astrological signs or the color of the annual report cover would not be an appropriate plaintiff. *Grossman* suggests that a defendant may strengthen his case by showing that a particular investor blindly followed the advice of his broker, but this depends upon the basis of the broker's advice, *Grossman*, 589 F. Supp. at 404; see also *Masri v. Wakefield*, 106 F.R.D. 322, 325 (D. Colo. 1984) (plaintiff's "unique investment strategy" made him atypical). In *Koenig v. Benson*, 117 F.R.D. 330 (E.D.N.Y. 1987), plaintiff was found to be atypical since his investment decision was inexplicable if based on market factors: he testified that he wanted

an investor's sophistication or experience does not defeat typicality,¹¹² courts bar as class representatives plaintiffs whom they suspect have an investment strategy not primarily based on market factors. Speculators, for example, have been held ineligible,¹¹³ as have plaintiffs whose investment decisions were apparently based on nonpublic information.¹¹⁴

b. The Short Seller

An investor who decides that a particular stock is overvalued may sell short. However, when the anticipated fall in value does not occur because of alleged misstatements, the investor is injured because of losses he incurs in covering his short position. Two decisions have held that the short seller is not entitled to recover under a fraud on the market approach, but must establish his own reliance.¹¹⁵

The Third Circuit, in *Zlotnick v. TIE Communications*,¹¹⁶ emphasized the traditional role of reliance in rule 10b-5 actions, and treated fraud on the market as simply a presumption of indirect actual reliance. Because most investors rely on the market price of the stock as an indication of its value and because an increase in the value of the stock will induce their purchase, it is appropriate to presume that misstatements had this effect. Nevertheless, the Third Circuit held that the short seller is not entitled to the presumption of reliance.¹¹⁷ First of all, the fact of his short sale is evidence that he did not rely on the market price as an accurate valuation of the stock. Secondly, he did not make his covering purchase because of the increase in the

a "safe investment" and that he relied on the advice of his son, yet the published reports with which his son was familiar made it clear the corporation was not a safe investment. *Id.* at 337.

¹¹² See *Priest v. Zayre Corp.*, 118 F.R.D. 552 (D. Mass. 1988); *Baum v. Centronics Data Computer Corp.*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,797 (D.N.H. May 15, 1986); *Biben v. Card*, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,462 (W.D. Mo. Jan. 6, 1986); *Stoller v. Baldwin-United Corp.*, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,298 (S.D. Ohio June 4, 1985).

¹¹³ See, e.g., *Koenig*, 117 F.R.D. at 335 (stating that the fact that plaintiff is a sophisticated speculator is "irrelevant unless those differences make his claims inconsistent with those of the class as a whole"); see *Katz*, 117 F.R.D. at 409 (dictum) (evidence did not support allegation of speculation, but court discussed speculative behavior as a factor in determining whether plaintiff relied on the integrity of the market).

¹¹⁴ See, e.g., *In re Storage Technology Corp. Sec. Litig.*, 113 F.R.D. 113 (D. Colo. 1986); *Zandman v. Joseph*, 102 F.R.D. 924, 931 (N.D. Ind. 1984).

¹¹⁵ *Zlotnick v. TIE Communications*, 836 F.2d 818 (3d Cir. 1988); *Moelis v. ICH Corp.*, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,220 (S.D.N.Y. Apr. 16, 1987).

¹¹⁶ 836 F.2d 818 (3d Cir. 1988).

¹¹⁷ *Id.* at 823.

stock's price, but rather in spite of it.¹¹⁸ The court rejected plaintiff's argument that while he did not believe the price was an accurate reflection of the stock's value at the time of his short sale, he did expect that the market price would correct itself downward by the time of his covering transaction¹¹⁹ and that the corporation's alleged misstatements interfered with the market's ability to correct itself.¹²⁰ In rejecting the causation argument, the court emphasized the distinction between a causation-based and a reliance-based theory. It correctly observed that the short seller is complaining of a fraud perpetrated on the market. Fraud on the market, according to the Third Circuit, does not allow a nonrelying trader to recover. Rather, all it does is create a presumption that most traders relied on the integrity of the market price of the stock.¹²¹ Since plaintiff was complaining of an injury caused by other investors' reliance, not his own, the fraud was perpetrated on the market, not on plaintiff. The court took the traditional common law approach, requiring actual indirect reliance and refusing to allow recovery to nonrelying traders.¹²²

Similarly, in *Burlington Industries, Inc. v. Edelman*,¹²³ the court rejected the issuer's invocation of fraud on the market in its suit against an unwelcome suitor, charging it with misstatements about the corporation. Like the short seller, the issuer did not rely on information in the marketplace to ascertain the value of its stock.¹²⁴ The court said that even if the target corporation could demonstrate reliance, it was unlikely that the target could show that its reliance was reasonable in view of its superior access to information about its own stock.¹²⁵ In effect, the court said the plaintiff would not be allowed to assert that it relied.

Zlotnick and *Burlington Industries* are both cases in which the courts applied a traditional approach, requiring actual indirect reli-

¹¹⁸ *Id.* at 823-24.

¹¹⁹ *See id.* at 823.

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² Another case dismissed a short seller's complaint for failure to allege reliance and held that he was not entitled to bring a fraud on the market claim. *Moelis v. ICH Corp.*, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,220 (S.D.N.Y. Apr. 15, 1987). Another district court, however, has suggested that *Basic* undercuts the validity of *Zlotnick*. *See In re Western Union Sec. Litig.*, 120 F.R.D. 629, 637 (D.N.J. 1988). The court in *Western Union* noted that [w]hile *Zlotnick* can arguably be seen as a cutting-back on the potential scope of *Peil*, we find its validity somewhat questionable in light of *Basic*. . . . Not only is *Basic* a later opinion of a superior court, it also makes several positive references to *Peil*, . . . the scope of which *Zlotnick* arguably constricts.

¹²³ 666 F. Supp. 799 (M.D.N.C. 1987).

¹²⁴ *Id.* at 807.

¹²⁵ *Id.*

ance. Under a pure causation approach, the results may have been different with the reliance hurdle eliminated.

c. Plaintiffs with No Choice

Also reflecting common law principles on reliance, courts have held that plaintiffs who have no choice cannot invoke fraud on the market. For example, in *Grossman v. Waste Management, Inc.*,¹²⁶ the court said that the presumption of reliance is rebutted by showing that the truth would not make a difference to the investor. Consequently, a plaintiff could not bring a claim based on alleged misstatements in a prospectus in connection with a merger, when she mistakenly believed that she had no choice but to accept the shares.¹²⁷ Similarly, in *Susman v. Lincoln American Corp.*,¹²⁸ plaintiff, a minority shareholder cashed out in a going-private transaction, had no choice and hence reliance could not be presumed. Under traditional reliance principles, even if an investor is lied to, he is not injured by the lie if he could not have acted differently. However, recovery would be allowed under a causation-based theory.

B. Shores' Progeny

Despite its weak theoretical justification,¹²⁹ the version of fraud on the market originating in *Shores v. Sklar*¹³⁰ remains good law in at least three circuits,¹³¹ although the Eleventh Circuit recently indicated

¹²⁶ 589 F. Supp. 395 (N.D. Ill. 1984).

¹²⁷ *Id.* at 412-13.

¹²⁸ 578 F. Supp. 1041 (N.D. Ill. 1984). Plaintiff's claim that reliance was not necessary was based on *Affiliated Ute's* omissions theory and not on fraud on the market. *Id.* at 1060.

¹²⁹ See Black, *supra* note 16, at 453.

¹³⁰ 647 F.2d 462 (5th Cir. May 1981) (en banc), *cert. denied*, 459 U.S. 1102 (1983). The judges of the Fifth Circuit were split 12-10.

¹³¹ The *Shores* rationale has been approved by the Fifth, Eleventh, and Tenth Circuits. See *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1119 (5th Cir. 1988), *petition for cert. filed*, 57 U.S.L.W. 3695 (U.S. Mar. 13, 1989) (No. 88-1506); *Ross v. Bank South, N.A.*, 837 F.2d 980, 1002 (11th Cir.), *vacated and reh'g granted*, 848 F.2d 1132 (11th Cir. 1988); *T.J. Raney & Sons, Inc. v. Fort Cobb, Okla. Irrigation Fuel Auth.*, 717 F.2d 1330, 1333 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984).

Various district courts, unguided by their respective circuit courts, have also considered the *Shores* rationale. In *Frankel v. Wyllie & Thornhill, Inc.*, 537 F. Supp. 730 (W.D. Va. 1982), the Western District of Virginia accepted the *Shores* characterization of fraud on the market, and stated its belief that the Fourth Circuit will adopt fraud on the market at some time in

it will reexamine the doctrine en banc when it vacated its decision in *Shores* seven years after the en banc decision in the Fifth Circuit.¹³² The Fifth Circuit held that although the purchaser's failure to read the offering circular barred his executor from asserting a claim based on alleged material misstatements in that document, it did not prevent the executor from asserting a claim based on fraud in bringing to the market bonds which were unmarketable.¹³³ If the purchaser was willing to purchase any bonds that were "entitled to be marketed" and to accept any marketable risk, plaintiff would establish the purchaser's reliance on the "integrity of the offerings of the securities market."¹³⁴

On remand, the district court denied class certification because *Shores*, as executor of the purchaser's estate, was not a typical class representative. The district court interpreted the Fifth Circuit's decision as limiting the class to purchasers who had not relied on the offering circular and who were willing to accept any marketable risk. Since both the purchaser and his broker were dead, *Shores* would

the future. *Id.* at 737.

In the Seventh Circuit, the Southern District of Illinois, while noting that *Shores* has been criticized by commentators, nevertheless found its reasoning persuasive. *Goldwater v. Alston & Bird*, 664 F. Supp. 403, 410, 411 (S.D. Ill. 1986) (allegations "that defendants engaged in a scheme to market bonds on the tax exempt bond market, that the sale of the bonds constituted a fraud on the tax exempt bond market, that plaintiff relied on the integrity of the market, and as a result of the scheme, plaintiff was damaged" stated a fraud on the market claim); see also *Goldwater v. Alston & Bird*, 116 F.R.D. 342, 348-50 (S.D. Ill. 1987) (on motion for class certification).

Lastly, in *Rose v. Arkansas Valley Envtl. & Util. Auth.*, 562 F. Supp. 1180, 1203 (W.D. Mo. 1983), the Western District of Missouri (located within the Eighth Circuit) accepted the *Shores* rationale. *Rose* involved the marketing of bonds which were

"unsecured or virtually unsecured, . . . issued without any appropriate closing procedure, and . . . premised upon a project which was known to be likely if not virtually certain to fail . . . indeed appear[ing] to have been so lacking in basic essentials that, absent a fraudulent scheme or plan, . . . would never have been issued or marketed."

Id. at 1206. These facts, in conjunction with plaintiff's express allegation of reliance on the market, adequately stated a cause of action. *Id.*

¹³² After the Fifth Circuit's 1981 decision in *Shores*, 647 F.2d 462, the case was remanded to the district court. *Id.* at 422. The district court denied class certification, *Shores v. Sklar*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,874 (N.D. Ala. July 30, 1986). No immediate appeal was taken from the denial of class certification, and *Shores* and the defendants reached a settlement. *Shores v. Sklar*, 844 F.2d 1485, 1489 (11th Cir.), *vacated and reh'g granted*, 855 F.2d 722 (11th Cir. 1988). Subsequently, an appeal was taken, and the Eleventh Circuit reversed the district court's denial of certification. *Id.* at 1495. This decision was later vacated, as a petition for rehearing and suggestion for rehearing en banc was granted. *Shores*, 855 F.2d 722.

¹³³ *Shores*, 647 F.2d at 469. The court defined "fraudulently marketed" as involving a fraudulent scheme "so pervasive that without it the issuer would not have issued, the dealer could not have dealt in, and the buyer could not have bought these Bonds, because they would not have been offered on the market at any price." *Id.* at 464 n.2.

¹³⁴ *Id.* at 469.

not be able to establish why the purchaser made the investment.¹³⁵ The three-judge panel of the Eleventh Circuit, in reversing the district court's denial of class certification, held that in this situation individual issues of reliance virtually disappear: it did not matter if the class consisted of purchasers who read the offering circular, as well as those who did not; it did not matter that the executor could not show the purchaser's reasons for the purchase; it did not matter whether or not the purchaser would accept any marketable risk. Virtually all that mattered was the fraud in bringing unmarketable bonds to the market.¹³⁶

Since the decision of the three-judge panel in the Eleventh Circuit has been vacated, the status of *Shores* in that Circuit is unresolved. As the Fifth Circuit's original *Shores* decision was decided en banc by a narrow margin, the doctrine has met strong resistance from the outset.

Shores, and most of the cases following it, involved the offering of municipal bonds, which are not subject to the registration requirements of the Securities Act of 1933.¹³⁷ Hence, the purchasers of these bonds do not have a remedy for misleading statements in the prospectus under section 11 of the Securities Act.¹³⁸ Courts thus use the *Shores* approach to transform a claim necessarily based on rule 10b-5 into the equivalent of a section 11 claim. This observation is borne out by the general confinement of *Shores* to municipal bond offerings. Efforts to extend it to other forms of investments have met with mixed results. The Eleventh Circuit, in *Kirkpatrick v. J.C. Bradford*

¹³⁵ *Shores*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,874, at 94,250.

¹³⁶ *Shores*, 844 F.2d at 1492-95.

¹³⁷ Municipal bonds are exempted securities. 15 U.S.C. § 77c(a)(2) (1982).

¹³⁸ *Id.* § 77k(a). The issuer of registered securities has virtually absolute liability for material misstatements in the registration statement. Section 11(a)(1) of the Securities Act of 1933 subjects to civil liability for material untruths or omissions in the registration statement "every person who signed the registration statement." *Id.* § 77k(a)(1). Section 6(a) of the Securities Act requires the issuer to sign the registration statement, *id.* § 77f(a), thereby subjecting issuers to section 11 liability. See *Greenapple v. Detroit Edison Co.*, 468 F. Supp. 702 (S.D.N.Y. 1979), *aff'd*, 618 F.2d 198 (2d Cir. 1980). Its only defense is to prove that the purchaser knew the truth. Section 11(a) of the Securities Act provides for liability "unless it is proved that at the time of such acquisition [the purchaser] knew of such untruth or omission." 15 U.S.C. § 77k(a) (1982); see *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 575 (E.D.N.Y. 1971). Further, the purchaser of registered securities need only show that he relied on the registration statement if "the issuer has made generally available to its security holders an earnings statement covering a period of at least twelve months beginning after the effective date of the registration statement." 15 U.S.C. § 77k(a) (1982). Even in this case, reliance can be established without proof of the reading of the registration statement. *Id.* "Reliance [can] be shown if [plaintiff] relied on conversations with persons who knew of the contents of the statement and based their opinions on its contents, or if he read articles in newspapers or financial periodicals of like import." *Rudnick v. Franchard Corp.*, 237 F. Supp. 871, 873 (S.D.N.Y. 1965).

& Co.,¹³⁹ accepted the *Shores* rationale in a class action against dealers who marketed oil limited partnerships, but courts in other circuits have rejected it.¹⁴⁰ These courts have also declined to apply *Shores* to private placements¹⁴¹ and to exchange offers.¹⁴² Nevertheless, assuming the continued viability of *Shores*, the key questions are when does the presumption apply and how can it be rebutted.

1. Applying the Presumption

The original Fifth Circuit opinion identified three factors which had to be present. Plaintiff had to allege a fraud or scheme, not just misstatements in an offering circular.¹⁴³ The fraud had to be the marketing of bonds which were not entitled to be marketed; it was not sufficient if the bonds were simply overpriced.¹⁴⁴ These two factors, however, coalesced into one: plaintiff must convince the court that the misstatements enabled the defendants to sell bonds that otherwise could not be sold. Finally, the purchaser must have been willing to accept any marketable risk.¹⁴⁵ As the district court, in denying class certification in *Shores* observed, the last requirement focused attention on the purchaser and thus introduced a subjective, individual element of proof that jeopardized the utility of the class action.¹⁴⁶ Hence, not surprisingly, this factor was eliminated in another significant Eleventh Circuit decision, which has also recently been vacated, *Ross v. Bank South, N.A.*¹⁴⁷

Ross involved an offering of tax-exempt bonds. Unlike *Shores*,

¹³⁹ 827 F.2d 718 (11th Cir. 1987), *cert. denied*, 108 S. Ct. 1221 (1988).

¹⁴⁰ See, e.g., *Sanders v. Robinson Humphrey/Am. Express, Inc.*, 634 F. Supp. 1048, 1063-64 (N.D. Ga. 1986) (finding *Shores* inapplicable to limited partnerships not traded on the open market), *cert. denied*, 108 S. Ct. 1220 (1988).

¹⁴¹ See *Lubin v. Sybedon Corp.*, 688 F. Supp. 1425, 1446 (S.D. Cal. 1988); *Platsis v. E.F. Hutton & Co.*, 642 F. Supp. 1277, 1301 (W.D. Mich. 1986), *affd*, 829 F.2d 13 (6th Cir. 1987), *cert. denied*, 108 S. Ct. 1227 (1988).

¹⁴² See *Masri v. Wakefield*, 106 F.R.D. 322, 325 (D. Colo. 1984).

¹⁴³ The *Shores* court indicated that "[t]he schemes must, of course, be one within the 'manipulative' condemnation of the securities law." *Shores*, 647 F.2d at 470 n.8 (citing *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977)).

¹⁴⁴ *Shores*, 647 F.2d at 469-70.

¹⁴⁵ *Id.* at 470.

¹⁴⁶ *Shores v. Sklar*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,874, at 94,250 (N.D. Ala. July 30, 1986).

¹⁴⁷ 837 F.2d 980 (11th Cir.), *vacated and reh'g granted*, 848 F.2d 1132 (11th Cir. 1988). Subsequent to *Ross*, the Eleventh Circuit reversed the district court's denial of class certification in *Shores*, relying on *Ross*' elimination of the reliance on market integrity element. *Shores*, 844 F.2d 1485, 1492 (11th Cir. 1988).

however, the two plaintiffs purporting to represent the class of purchasers were alive and could explain why they made the investment. Both testified that they would not have purchased the bonds if they had been aware of the information contained in the offering circular. In addition, one of them stated that he relied on his broker's misrepresentations. Defendants argued that these statements established that plaintiffs did not rely on the integrity of the market and that, in fact, they were not willing to accept any marketable risk. According to defendants, a willingness to accept any marketable risk meant that the purchaser's decision was "based entirely on his individual assessment of the market as a filtering mechanism and that he would have purchased the securities even if he had read the offering circular."¹⁴⁸

In rejecting defendants' argument and dispensing with the "willing to accept any marketable risk" factor, the Eleventh Circuit made it clear that reliance has been eliminated as an element.¹⁴⁹ This follows from the conclusion that the sole purpose of reliance is to establish causation;¹⁵⁰ if plaintiff can establish causation in some other way, reliance becomes irrelevant. If he can prove the type of pervasive fraud necessary to establish a fraudulent marketing of securities, he has satisfied causation, because without the fraud he could not have purchased the bonds. There is no need to examine what the purchaser would have done if he had read the disclosure document.¹⁵¹

Thus, the *Shores* presumption is applicable only if the bonds were not entitled to be marketed—i.e., they could not be marketed absent fraudulent representations. If the bonds could have been sold without the misstatements, they were indeed marketable and plaintiff has merely alleged a fraudulent overstatement of value, in which instance the plaintiff must establish reliance on the misrepresentation. *Ross* illustrates the difficulty of the distinction, as the Eleventh Circuit itself noted.¹⁵² In *Shores*, an allegedly safe investment was a "sham"; in *Ross*, however, the bonds were marketed as a risky investment.¹⁵³ In principle, as the court noted, this should not make a difference. If an investment is unmarketable, it is just as much fraud to pass it off as a risky investment as it is a safe one.¹⁵⁴ Notwithstanding

¹⁴⁸ *Ross*, 837 F.2d at 996-97.

¹⁴⁹ *Id.* at 997.

¹⁵⁰ *See id.* at 993-94.

¹⁵¹ *Id.* at 994-95.

¹⁵² *Id.* at 1001-02 ("[w]hether or not the bonds would have been 'marketable' absent the fraud is a complex factual inquiry").

¹⁵³ *Id.* at 999.

¹⁵⁴ *Id.* The court then explained that the *Shores* emphasis of "fraud on a broader scale," concerned the fraud's "effect on the marketability of the bond, and not . . . the extent of deception." *Id.*

the logical purity of this assertion, the court's review of the evidence shows the difficulty in distinguishing between an unmarketable bond, i.e., one that could not be sold at any price, and a risky bond. Obviously, there is no clear distinction—it is difference of degree. The *Ross* court said that in distinguishing these securities, the focus must not be on who purchases the bonds, but on who sells them. The issue is whether bond sellers would have been able to price the bonds without fraud at a price and rate which would attract informed buyers.¹⁵⁵

The Fifth Circuit, in upholding the district court's denial of class certification in *Abell v. Potomac Insurance Co.*,¹⁵⁶ attempted another formulation of what makes investments unmarketable. Similarly alluding to the investment in *Shores* as a "hoax," the court held that bonds were "not entitled to be marketed" only if the promoters knew that the enterprise was patently worthless. In *Abell*, plaintiffs could not establish this because these bonds always had a legitimate value in the bond market, even after all the unfavorable information about the project was known.¹⁵⁷

2. Rebutting the Presumption

If plaintiff establishes that defendants offered unmarketable securities, defendants seldom will be able to escape liability. Because the fraud caused the purchasers' injury, rarely will there be an intervening factor significant enough to break the chain of causation.¹⁵⁸ In *Kirkpatrick v. J.C. Bradford & Co.*,¹⁵⁹ the Eleventh Circuit held that class action treatment is not precluded by the possibility that some purchasers might have relied on factors other than the integrity

¹⁵⁵ *Id.* at 1002.

¹⁵⁶ 858 F.2d 1104 (5th Cir. 1988).

¹⁵⁷ *Id.* at 1122.

¹⁵⁸ See 4 A. BROMBERG & L. LOWENFELS, *supra* note 42, § 8.6(662), at 8:828 (noting that in a *Shores* situation, though the presumption is theoretically rebuttable, such a rebuttal is difficult for the defendant to show because the defendant "cannot show that his or her fraud did not affect the market price on which the presumption operates"); see also *Ross*, 837 F.2d at 995 (distinguishing the rebuttal of *Shores* from that of *Blackie*, noting that "[i]n a *Blackie* type case, the defendant can show that his fraud had no effect on the market price . . . [while a] *Shores* defendant can make no such showing . . . because his fraud creates the [security] itself" (citation omitted)).

¹⁵⁹ 827 F.2d 718 (11th Cir. 1987). *Kirkpatrick* extended the *Shores* theory to include securities other than municipal bonds (oil limited partnerships) and brokers and dealers as well as issuers as defendants. *Id.*

of the market.¹⁶⁰ In *Ross*, the Eleventh Circuit took an additional step in holding that the purchaser is entitled to recover so long as he did not intentionally refuse to investigate known or obviously apparent risks associated with the bonds.¹⁶¹ Unless defendant can show a compelling reason, such as the purchaser's inside information or his unreasonable failure to investigate, defendant cannot rebut the presumption that investors rely on the integrity of the market to produce bonds which are entitled to be marketed.

C. *Fraud on the Market as Market Manipulation*

1. Market Manipulation Generally

Fraud on the market, in some cases, is used as a synonym for market manipulation. The statement that a trader is entitled to rely on the integrity of the market is the equivalent of saying that a trader may suffer injury when the market or price for a stock is tampered with. Accordingly, he may have a claim against dealers that created an artificial price and an artificial market.¹⁶²

Whether market manipulation claims form a separate category of fraud on the market claims is far from clear. Despite the fact that section 10(b) prohibits manipulative as well as deceptive devices, market manipulation has received curiously little attention in the private claims under rule 10b-5. The Supreme Court has articulated a narrow definition of market manipulation, referring to it as "virtually a term of art"¹⁶³ and limiting it to the acts described in section 9 of the Securities Exchange Act of 1934.¹⁶⁴ Accordingly, if statements that artificially affect stock prices do not constitute manipulation under section 9, they must be deceptive, and, arguably, reliance is required. The Fifth Circuit took this position in *Chemetron Corp. v. Business Funds, Inc.*,¹⁶⁵ asserting that when a section 10(b) claim involved market manipulation accomplished by fraudulent misstate-

¹⁶⁰ *Id.* at 723 (noting that the "*Shores* fraud-on-the-market . . . makes virtually irrelevant the possibility that the various purchasers may have relied on different representations regarding the desirability of the particular security").

¹⁶¹ *Ross*, 837 F.2d at 997.

¹⁶² See *Index Fund, Inc. v. Hagopian*, 609 F. Supp. 499, 507 (S.D.N.Y. 1985).

¹⁶³ See, e.g., *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 6-8 (1985); *Santa Fe Indus. v. Green*, 430 U.S. 462, 476-77 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976).

¹⁶⁴ See 15 U.S.C. § 78i (1982).

¹⁶⁵ 718 F.2d 725 (5th Cir. 1983).

ments, the plaintiff must establish reliance.¹⁶⁶ Other cases besides *Shores*, however, have emphasized the rule's dichotomy between misstatements and fraudulent schemes in finding that plaintiff did not have to show reliance when complaining of an injury caused by a scheme that artificially affected stock prices.¹⁶⁷

2. Brokers and Market Manipulation

In cases involving charges of market manipulation allegedly perpetrated principally by dealers in the stock, courts have split on whether fraud on the market is applicable outside the *Blackie* or *Shores* context.¹⁶⁸ The facts in most of these cases are the antithesis

¹⁶⁶ See *id.* at 728.

¹⁶⁷ The most famous of these are *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380-81 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975), and *Chris-Craft Indus. v. Piper Aircraft Corp.*, 480 F.2d 341, 373-74 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973), which are discussed in Black, *supra* note 16, at 445-46.

¹⁶⁸ In *Shapiro v. Merrill Lynch & Co.*, 634 F. Supp. 587 (S.D. Ohio 1986), the district court applied fraud on the market against defendant brokers. Careful to qualify itself, however, the court made it clear that it was not saying "that '[a]ny broker who makes a material misrepresentation or omission concerning a nationally traded security could be liable to every person who subsequently purchases that security whether or not a customer,'" but instead "only that a plaintiff may allege liability where the purported fraud is so broad that it infected the market place and distorted the stock price." *Id.* at 597 (quoting Defendant's Reply Memorandum at 27) (citation omitted). Further, the court limited the class of plaintiffs to those who "dealt with" the defendant, because they "were more likely than other purchasers on the open market to rely on [the broker's representations]." *Id.* The court additionally noted as relevant to the application of fraud on the market to plaintiff's allegation that defendant's position as "a major brokerage house known to have multiple ties with [the issuer] and information about [the issuer's] financial condition . . . had a significant impact on the market price" of the securities in issue. *Id.* In *Bresson v. Thompson McKinnon Sec., Inc.*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,855 (S.D.N.Y. July 22, 1986), the Southern District Court of New York recognized that reliance on the "integrity of the market" was sufficient to defeat a Federal Rule of Civil Procedure 9(b) motion to dismiss for failure to adequately plead fraud. *Id.* at 94,158. *Bresson* involved an action by investors against their brokers for, inter alia, alleged misrepresentations and omissions concerning the quality of certain limited partnership interests which plaintiffs had purchased through defendants. *Id.* at 94,157.

In *Nelsen v. Craig-Hallum, Inc.*, 659 F. Supp. 480 (D. Minn. 1987), the court found fraud on the market applicable to this action against brokers to the extent that plaintiffs did not have "direct contact with the [broker] and [did not] base assertions of liability 'on affirmative misrepresentations made to [them] personally.'" *Id.* at 485 (quoting *McNichols v. Loeb Rhoades & Co.*, 97 F.R.D. 331, 341 (N.D. Ill. 1982)). This is inapposite to the reasoning of *Shapiro*, which required that the plaintiffs had "dealt with" the defendant. *Shapiro*, 634 F. Supp. at 597.

The court in *Seiler v. E.F. Hutton & Co.*, 102 F.R.D. 880 (D.N.J. 1984), however, "seriously question[ed] the relevance of a 'fraud-on-the-market' theory to a lawsuit against a stockbroker rather than against the issuer of the stock," *id.* at 890 n.5, but did not rule on the issue. *Platsis v. E.F. Hutton & Co.*, 642 F. Supp. 1277 (W.D. Mich. 1986), *aff'd*, 829 F.2d 13 (6th Cir. 1987),

of the *Blackie* pattern since, like the classic market manipulation case, the securities are ordinarily thinly traded and involve initial offerings or other situations involving less reliance on the market as a price indicator.¹⁶⁹ They also do not fit within *Shores* because the allegation is an artificial inflation of value, not utter worthlessness,¹⁷⁰ and they do not involve revenue bonds. In the cases applying fraud on the market against the dealers, the courts have emphasized that the securities firm disseminated the misstatements widely and that it had substantial involvement in the company's financial affairs.¹⁷¹ Conversely, cases rejecting its application have emphasized that the misstatements were disseminated by the account representative, not as the firm's uniform policy, and that the brokers had personal relationships with the customers.¹⁷² In cases involving not only misrepresentations but also conduct that affected the market price, courts have been more receptive to allowing the claim without requiring reliance. For example, in *Gavron v. Blinder Robinson & Co.*,¹⁷³ the dealer allegedly sought to depress the price of the stock, not only by making misstatements, but also by refusing to solicit purchase orders, and when it accepted purchase orders from customers, it delayed execution, anticipating a reduced price.¹⁷⁴ Thus, when broker-dealer firms act institutionally to affect market prices, it is appropriate to

cert. denied, 108 S. Ct. 1227 (1988), involved a suit by an investor against his broker based on the broker having committed a fraud on the market by "knowingly or recklessly [having] sold 'junk,' " limited partnerships that were only marketable "because [defendant] sold them." *Id.* at 1300. The court found fraud on the market inapplicable because the securities in issue were "not purchased on an open market," but through a private placement. *Id.* at 1301. Apparently, in the absence of an open market transaction, this court would not apply the theory against a broker. *See id.*

¹⁶⁹ *See, e.g., Bresson*, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,855, at 94,152 to 94,153 (S.D.N.Y. July 22, 1986) (initial offering of oil and gas limited partnerships); *Platsis*, 642 F. Supp. at 1301 (private placement of limited partnership interests).

¹⁷⁰ *See, e.g., Nelsen*, 659 F. Supp. at 482 (plaintiff alleging defendant's fraudulent conduct impacted on market price); *Platsis*, 642 F. Supp. 1277; *Shapiro*, 634 F. Supp. at 597 (theory applicable when broker's actions "distort the stock price").

¹⁷¹ *See, e.g., Nelsen*, 659 F. Supp. at 482; *Shapiro*, 634 F. Supp. at 597. In *Nelsen*, defendant broker who underwrote previous issuance of common stock "was a market-maker in common stock, and provided financial consulting and investment banking services" for the issuer, was present at board meetings "and was also party to confidential information and deliberations of [the issuer's] directors. *Nelsen*, 659 F. Supp. at 482. Similarly, in *Shapiro*, defendant broker had many ties with the issuer, possessing information concerning its financial condition. It was alleged that the defendant was a creditor of the issuer, a seller of the issuer's premium deferred annuities as well as issuer's investment analyst. *Shapiro*, 634 F. Supp. at 597.

¹⁷² *See, e.g., Platsis*, 642 F. Supp. 1277; *Seiler*, 102 F.R.D. 880. In *Seiler*, the court seriously questioned the applicability of fraud on the market in a suit against brokers rather than the issuer. *Id.* at 890-91 n.5.

¹⁷³ 115 F.R.D. 318 (E.D. Pa. 1987).

¹⁷⁴ *Id.* at 320.

adopt the causation approach because the firms are affecting the prices their customers must accept.

3. Proxy Statements and Market Manipulation

It has long been recognized that plaintiffs who received a misleading proxy solicitation in connection with a merger are not barred from asserting the claim even though they did not rely on the alleged misstatement.¹⁷⁵ These cases emphasize that the injury is suffered by the group and that a shareholder can be injured because of the reliance of others.¹⁷⁶ In *Keyser v. Commonwealth National Financial Corp.*,¹⁷⁷ for example, the court held that plaintiffs could represent the class of shareholders solicited to vote on a merger with another bank, even though they knew of the alleged material omission (merger overtures) from other published sources¹⁷⁸ and in fact voted against the merger.¹⁷⁹ *Keyser* thus continues a line of "pure causation" cases which hold that shareholders whose votes are solicited to approve a merger can complain of misstatements in the proxy materials disseminated to obtain shareholder approval.¹⁸⁰

¹⁷⁵ See *Kohn v. American Metal Climax, Inc.*, 458 F.2d 255, 269 (3d Cir.) ("to the extent a reliance factor is required, in the present context it is encompassed by the finding that the misrepresentation was material"), *cert. denied*, 409 U.S. 874 (1972). Compare *id.* with *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 797 (2d Cir. 1969) (holding that in a case involving nondisclosure of manipulation proof of individual reliance need not be shown), *cert. denied*, 400 U.S. 822 (1970).

Some courts have characterized cases involving fraudulent misrepresentations or omissions in proxy statements as a third category of fraud on the market. See *Frankel v. Wyllie & Thornhill, Inc.*, 537 F. Supp. 730, 735-40 (W.D. Va. 1982), *cited in* *Rose v. Arkansas Valley Envtl. & Util. Auth.*, 562 F. Supp. 1180, 1201 n.34 (W.D. Mo. 1983).

¹⁷⁶ *Crane Co.*, 419 F.2d at 797 ("[w]hat must be shown is that there was deception which misled [other] stockholders and that this was in fact the cause of plaintiff's claimed injury") (quoting *Vine v. Beneficial Fin. Co.*, 374 F.2d 627, 635 (2d Cir. 1967), *cert. denied*, 389 U.S. 970 (1968)).

¹⁷⁷ 121 F.R.D. 642 (M.D. Pa. 1988).

¹⁷⁸ *Id.* at 647-48. The court did not discuss whether the presumption of reliance is negated by "dissemination of more complete and accurate information in the press." *Id.* at 647 n.11. Another court found it "incredible" that defendant could make such an argument. *In re Western Union Sec. Litig.*, 120 F.R.D. 629, 638 (D.N.J. 1988).

The court in *In re Kulicke and Soffa Indus., Inc. Sec. Litig.*, 697 F. Supp. 183 (E.D. Pa. 1988), on the other hand, found it especially logical in a fraud on the market case to take into account other information in the marketplace. The latter approach is correct, although, in the context of proxy solicitations, a persuasive argument can be made that the solicitees who make a personal decision to vote based on direct solicitation are not affected by information outside the proxy materials.

¹⁷⁹ *Keyser*, 121 F.R.D. at 648.

¹⁸⁰ *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970). For an analysis of this decision and its place with the development of fraud on the market, see Black, *supra* note 16, at 442-44.

In proxy solicitation cases, courts have recognized that an investor is injured by the reliance of other traders and should recover despite a lack of reliance by the investor. This line of cases represents a chipping away of the well-entrenched, yet practically useless reliance requirement. Although this recognition can be the basis for the expansion of fraud on the market as a pure causation approach, these cases are traditionally explained as reflecting a favored treatment for recipients of proxy solicitation materials.

CONCLUSION

Fraud on the market is a phrase, not a theory. The lower courts most frequently use it to confer upon plaintiff a rebuttable presumption of reliance. This is reliance-based fraud on the market. The Supreme Court in *Basic Inc. v. Levinson*, while acknowledging this use of fraud on the market, did not, by its use of this reliance approach, rule out the possibility that fraud on the market might have useful application under a pure causation approach. In fact, Justice Blackmun made it clear he was not assessing the general validity of the theory. Notwithstanding Justice White's dissenting views to the contrary, the Court did not reject the notion of causation-based fraud on the market.

If the explanation for fraud on the market is that it establishes a rebuttable presumption of reliance, then it fails to explain the application of the label to cases which can only be explained on a pure causation theory. In *Shores*, in some actions against dealers, and in proxy solicitation cases, the pure causation approach is followed. *Shores v. Sklar*, however, had a controversial beginning and its future is very much in doubt because of the criticism that fraud on the market should not be applied in undeveloped market situations. The use of causation-based fraud on the market in the proxy solicitation area has been confined to that fact pattern. The most interesting development in causation-based fraud on the market is its application in actions against dealers that involve allegations more closely related to market manipulation than to fraudulent misstatements. To date, however, a coherent approach has not emerged from the various situations in which this pure causation approach to fraud on the market has been used.

In open market transactions, in which the price is set by other traders and the trader must accept that price, a forthright elimination of the reliance requirement is logical. The individual reasons behind an investment decision are not relevant. Once the decision to trade

is made, the investor becomes subject to the market's pricing mechanism, which causes him injury unless there is something unique to the individual investor that breaks the chain of causation. An added benefit of adopting this approach is that courts and commentators alike can dispense with the nonsensical reliance rules which have resulted from the perceived necessity of paying lip service to an out-of-place element borrowed from common law.

There is less justification for the pure causation approach in the context of initial public offerings, since the price is not set by other traders. Because the impetus for the *Shores* decisions is the well-founded judicial perception that the purchasers of revenue bonds should be entitled to some minimal assurance that the market offers protection against sham investments, the best way of providing for this would be for legislative enactment of an explicit remedy for purchasers of revenue bonds comparable to section 11 of the Securities Act of 1933.

Of the two ways in which fraud on the market can be used to deal with the difficulty or impracticability of proving reliance in rule 10b-5 cases, the pure causation approach emerges as the more sensible and useful alternative. Applying fraud on the market as simply a means of dispensing with the reliance requirement in certain situations would lead to a more logical and predictable approach to several of the situations discussed.